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IN THE
Supreme Court of the United States

OCTOBER TERM, 1991

BOB REVES, *et al.*,

Petitioners,

—v.—

ERNST & YOUNG,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE EIGHTH CIRCUIT

**BRIEF OF AMERICAN INSTITUTE OF
CERTIFIED PUBLIC ACCOUNTANTS AS
AMICUS CURIAE IN SUPPORT OF RESPONDENT**

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QUESTION PRESENTED

Whether the court below correctly held that the "conduct or participation" element of section 1962(c) of the RICO statute, which is embodied in the phrase "to conduct or participate, directly or indirectly, in the conduct of [the] enterprise's affairs," requires proof of some participation by the defendant in the operation or management of the RICO enterprise.

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PRELIMINARY STATEMENT

The American Institute of Certified Public Accountants (the "Institute") respectfully submits this brief as *amicus curiae* pursuant to Rule 37.3 of the Rules of this Court in support of respondent Ernst & Young and urges this Court to affirm the judgment of the United States Court of Appeals for the Eighth Circuit, entered in these proceedings on June 27, 1991, and reported at 937 F.2d 1310. This brief is submitted on consent of the parties, and their written consents are being filed with the Clerk of the Court contemporaneously herewith.

INTEREST OF THE INSTITUTE AS *AMICUS CURIAE*

The Institute is the national professional accounting organization, all of whose more than 300,000 members are certified public accountants. Among the Institute's purposes are the promotion and maintenance of high professional standards of practice. In the pursuit of those ends, the Institute has come to be accepted as the authoritative source of standards and procedures in its field.

As the issuer of these standards, the Institute has a profound interest in the scope and bases of civil liability in connection with auditors' performance of professional engagements sought to be imposed under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§ 1961-1968 ("RICO"), Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) ("Section 10(b)" and the "1934 Act") and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5 ("Rule 10b-5"). The Institute's substantial and legitimate interest in this body of law has long been recognized both by this Court and the Congress.¹

¹ On the subject of RICO, the Institute participated as *amicus curiae* in *Sedima, S.P.L.R. v. Imrex Co.*, 473 U.S. 479 (1985), *H.J. Inc. v. Northwestern Bell Tel.*, 492 U.S. 229 (1989), and *Holmes v. Securities Investor Protection Corp.*, 112 S. Ct. 1311 (1992). On the related subject of the scope of civil liability under the federal securities laws, the Institute was invited to

(footnote continued)

This case involves a claim against a member of the accounting profession and the impact of a potential reversal of the Eighth Circuit's ruling on accountants would be severe. Accountants play an integral role in the dissemination of financial information pursuant to the federal securities laws. When auditors express opinions on financial statements, they become exposed to suits brought by investors, creditors and others who may claim to have relied upon those statements in making investment decisions or entering into business transactions with auditors' clients. Upon the financial collapse of corporations, outside professionals, such as accountants, like other surviving solvent parties, are "targets of opportunity" in private RICO actions for treble damages. Dramatic expansions of civil liability under RICO, such as petitioners seek by urging this Court to reverse the decision below, foster "a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general." See *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 739, *reh'g denied*, 423 U.S. 884 (1975).

In this case, a class of purchasers of demand notes issued by the Farmer's Cooperative of Arkansas and Oklahoma, Inc. (the "Co-op") alleges that Arthur Young (the predecessor of respondent Ernst & Young) committed mail fraud and securities fraud as RICO predicate acts in connection with the accounting services it provided to the Co-op. The class members, petitioners before this Court, invoked section 1962(c) of RICO, which makes it unlawful "for any person employed by or associated with any enterprise . . . to conduct or participate, directly or indirectly, in the conduct of such enter-

(footnote continued)

and did submit a position paper to the United States Senate addressing the proposed scope of civil liabilities and damages under the 1934 Act. *Hearings on S. Res. 84 (72d Cong.), S. Res. 56, and S. Res. 97 Before the Comm. on Banking and Currency, 73d Cong., 1st Sess., pt. 15, at 7207-10 (1934)*. Furthermore, this Court has permitted the Institute to file briefs as *amicus curiae* on related securities laws issues in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976); *Touche Ross & Co. v. Redington*, 442 U.S. 560 (1979); *Aaron v. SEC*, 446 U.S. 680 (1980); *Ross v. A. H. Robins Co.*, 607 F.2d 545 (2d Cir. 1979), *cert. denied*, 446 U.S. 946 (1980); and *Basic Inc. v. Levinson*, 485 U.S. 224 (1988).

prise's affairs through a pattern of racketeering activity" 18 U.S.C. § 1962(c). The Eighth Circuit held that the "conduct" element of section 1962(c) requires that "[a] defendant's participation must be in the conduct of the affairs of a RICO enterprise, which ordinarily will require some participation in the operation or management of the enterprise itself." *Arthur Young & Co. v. Reves*, 937 F.2d 1310, 1324 (8th Cir. 1991), *cert. granted*, 112 S. Ct. 1159 (1992), quoting from *Bennett v. Berg*, 710 F.2d 1361, 1364 (8th Cir.) (en banc), *cert. denied*, 464 U.S. 1008 (1983). Arthur Young's involvement in the affairs of the Co-op (the RICO enterprise in this case) was limited to conducting annual audits, meetings with the Co-op's board of directors to explain the audits, and presentations at the annual meetings regarding the audits. The Eighth Circuit concluded that "these acts in no way rise to the level of participation in the management or operation of the Co-op." *Arthur Young, supra*, 937 F.2d at 1324.²

Petitioners now urge this Court to reverse the decision below on the ground that the "operation or management" standard is an unduly restrictive interpretation of RICO that conflicts with the statute's legislative purpose. The Institute and those who use its members' professional services have an important interest in a construction of RICO that brings consistency, predictability and coherence to the express requirements for civil liability under section 1962(c) of the statute.

2 In its *amicus* brief, the United States concedes that auditors are required to maintain independence, or "an arm's-length professional relationship with a client," and "[t]hat relationship, standing alone, does not implicate RICO." Brief for United States at 22, citing and quoting from *United States v. Arthur Young & Co.*, 465 U.S. 805, 818 (1984) ("'public watchdog' function [of accountants] demands that the accountant maintain total independence from the client at all times and requires complete fidelity to the public trust"). The Institute's Code of Professional Conduct also requires certified public accountants to "maintain objectivity" and "be independent in fact and appearance when providing auditing and other attestation services." Professional Standards, *Principles of Professional Conduct*, art. IV (AICPA 1991). A similar independence requirement for public accountants is imposed by SEC Regulation S-X, Rule 2-01(b), 17 C.F.R. § 210.2-01(b).

Because the decision below offers such a construction, the Institute urges its affirmance.

STATEMENT OF THE CASE

The petitioners in this case are Bob Reves, Robert H. Gibbs and Frances Graham, as representatives of a class of persons who purchased demand notes from the Co-op between February 15, 1980 and February 23, 1984. The Co-op was organized in 1946 and it sold demand notes to raise money for its operating expenses until it filed for bankruptcy on February 23, 1984.

Arthur Young was first retained to provide accounting services to the Co-op as its independent auditor in 1981. In that capacity, Arthur Young issued audit reports on the Co-op's financial statements for the years ending December 31, 1981 and December 31, 1982. Arthur Young's representatives also gave brief oral presentations on the financial condition of the Co-op at its annual meetings in May 1982 and March 1983.

The Co-op operated as a debtor-in-possession from the time of its bankruptcy filing until October 1984, when the bankruptcy court appointed a trustee. On February 14, 1985, the bankruptcy trustee filed an action in the United States District Court for the Western District of Arkansas on behalf of the Co-op and certain demand noteholders against 40 individuals and entities including the Co-op's general manager, members of the Co-op's board of directors, several of the Co-op's lawyers, Arthur Young, and two auditors that preceded Arthur Young.

The complaint asserted various state and federal claims against the defendants, including common law fraud, violations of the registration and disclosure provisions of the Arkansas Securities Act, and violations of Section 10(b), Rule 10b-5 and RICO. The gravamen of the complaint against Arthur Young was that it had misvalued the Co-op's assets and thereby allowed the Co-op's financial statements to be misstated. With respect to RICO, the complaint alleged that Arthur Young conducted or participated in the conduct of

the affairs of the Co-op through a pattern of racketeering activity consisting of mail fraud and securities fraud in violation of 18 U.S.C. § 1962(c).

After the close of extensive discovery, Arthur Young moved for summary judgment on the RICO claim and urged two grounds for dismissal: first, petitioners could not demonstrate that it had conducted or participated in the conduct of the Co-op's affairs within the meaning of section 1962(c) of RICO; and, second, that petitioners could not demonstrate that it had participated in a pattern of racketeering activity within the meaning of that statute. The district court granted Arthur Young's motion on the first ground and held that, under the Eighth Circuit's decision in *Bennett v. Berg, supra*, 710 F.2d at 1364, mere participation in auditing activities could not constitute participation in the conduct of the affairs of a RICO enterprise under section 1962(c).

Following a trial on the complaint's remaining claims, the jury found that Arthur Young had committed primary violations of section 10(b) of the 1934 Act and Rule 10b-5 and secondary violations of the Arkansas securities statute. The jury awarded actual damages of \$6.1 million to members of the class who purchased demand notes between the time that Arthur Young submitted its first audit report to the Co-op's board and the date on which the Co-op filed for bankruptcy.

Arthur Young and petitioners each appealed from the district court's judgment to the United States Court of Appeals for the Eighth Circuit. Initially, the Eighth Circuit held that the demand notes were not securities under federal and state law and reversed the district court judgment. See *Arthur Young & Co. v. Reves*, 856 F.2d 52 (8th Cir. 1988). This Court reversed that decision and held that the demand notes were securities under the federal securities laws. See *Reves v. Ernst & Young*, 110 S. Ct. 945 (1990).

On remand, the Eighth Circuit affirmed the district court judgment against Arthur Young under Section 10(b) of the 1934 Act, Rule 10b-5 and the Arkansas securities statute. The Eighth Circuit also affirmed the district court's grant of summary judgment for Arthur Young on the RICO claim. See 937 F.2d at 1324.

SUMMARY OF ARGUMENT

Section 1962(c) of RICO makes it unlawful "for any person employed by or associated with any enterprise . . . to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity" 18 U.S.C. § 1962(c). While the term "conduct" as used in section 1962(c) is undefined, the ordinary meaning of this word, RICO's legislative history and its structure all support the Eighth Circuit's conclusion that participation in the "operation or management" of a RICO enterprise's affairs must be proven in order to satisfy the "conduct" element of the statute. Most courts that have analyzed section 1962(c)'s "conduct" element separately have concluded that it should be interpreted to require proof of something more than a defendant's commission of offenses comprising the pattern of racketeering activity, even when the requisite pattern has a nexus to the statutory enterprise. The Eighth Circuit interpreted the "conduct" element to require proof of some participation in the "operation or management" of the affairs of the enterprise itself. This interpretation is not only faithful to the meaning and intent of the statute, but it also furthers important public policy considerations.

The question presented here is essentially one of statutory construction of certain of RICO's undefined language. The Eighth Circuit's interpretation of section 1962(c)'s "conduct" language to require that defendants participate in the "operation or management" of an enterprise's affairs is consonant with the ordinary meaning of the word "conduct," used in the key statutory passage both as a noun and as a verb. As a verb, it is synonymous with the word "manage;" as a noun it is synonymous with "management."

The legislative history of RICO also supports the "operation or management" standard. Contemporaneous statements by the sponsors of bills that ultimately were enacted as RICO demonstrate that section 1962(c) was intended to prohibit the operation and management of legitimate organizations by racketeers and organized crime. Moreover, the reports issued

by the Senate and House judiciary committees are replete with statements evidencing this legislative intent. In reports and statements by RICO's sponsors, there are repeated references to the "operation" of an enterprise by racketeers or organized crime as an activity that section 1962(c) was designed to eliminate. In sum, the legislative history of section 1962(c) establishes that the "conduct or participate" language in the statute requires some involvement by defendants in the operation or management of enterprises.

Significantly, the "operation or management" standard has been adopted by most of the Courts of Appeals that have considered the separate "conduct" element of section 1962(c). As this Court has recognized, the "conduct" element of section 1962(c) is separate from that section's "through" element. The Courts of Appeals for the Fourth, Eighth, Ninth and District of Columbia Circuits have analyzed section 1962(c)'s "conduct" element separately and each has adopted in slightly varying form the "operation or management" standard. Only the Courts of Appeals for the Fifth and Eleventh Circuits have concluded that it is not necessary for a RICO defendant to participate in the operation or management of an enterprise under section 1962(c). By requiring that defendants have a significant degree of involvement in the conduct of an enterprise's affairs, the majority of decisions in the Circuits thus ensure that RICO liability is kept within legislatively defined bounds, and this view should be affirmed here.

A contrary result would effectively extend the reach of RICO to defendants who had little, if any, involvement in the conduct of an enterprise's affairs. Such a result will contribute to the continuing, undisciplined growth of RICO actions against accountants and other professionals. The exposure to risk of treble damages, potentially irreparable harm to professional reputation, and time-consuming and expensive litigation are factors that promote extortive settlements. The unwarranted expansion of accountants' liability may impede or prevent the critical flow of financial information because accounting services will become more expensive or unavailable, which ultimately will harm investors, the capi-

tal markets, and competition. All these adverse policy results are avoided by adoption of the "operation or management" standard which provides a principled basis on which to tailor liability to statutorily prohibited acts.

ARGUMENT

POINT I

THE DECISION BELOW INTERPRETED THE CONDUCT ELEMENT OF SECTION 1962(c) IN ACCORDANCE WITH THE PLAIN LANGUAGE, LEGISLATIVE HISTORY AND STRUCTURE OF RICO.

As this Court has recognized, "the major purpose" of RICO is "to address the infiltration of legitimate business by organized crime." *United States v. Turkette*, 452 U.S. 576, 591 (1981). In support of this salutary purpose, Congress has declared that "[t]he provisions of [RICO] shall be liberally construed to effectuate its remedial purposes," Organized Crime Control Act of 1970, Pub. L. No. 91-452, § 904(a), 84 Stat. 922, 947, and this Court has held that "RICO is to be read broadly," *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 497 (1985).

As RICO's treble damages and attorney's fee provision have made RICO the statutory action of choice among civil litigants, see 18 U.S.C. § 1964(c), this Court has observed that, "[i]nstead of being used against mobsters and organized criminals, it has become a tool for everyday fraud cases brought against 'respected and legitimate "enterprises." ' " *Sedima, supra*, 473 U.S. at 499, quoting from *Sedima, S.P.R.L. v. Imrex Co.*, 741 F.2d 482, 487 (2d Cir. 1984). In response to "this increasing divergence," and the "'extraordinary, if not outrageous,' uses to which civil RICO has been put," this Court also has expressed concern that, "in its private civil version, RICO is evolving into something quite different from the original conception of its enactors." *Sedima, supra*, 473 U.S. at 499, 500.

This Court's well-founded expressions of concern regarding the use of RICO in garden-variety fraud cases and ordinary commercial disputes involving respected business persons and firms make it essential that section 1962(c)—RICO's most commonly invoked proscriptive provision—be interpreted and applied in accordance with its plain language, legislative history and structure. An analysis of RICO's plain language, legislative history and structure demonstrates that the court below was correct in holding that section 1962(c)'s "conduct or participate" element requires proof of "some participation" by defendants "in the operation or management of the enterprise itself." *Arthur Young, supra*, 937 F.2d at 1324.

A. The "Operation Or Management" Standard Is Supported By The Ordinary Meaning Of The Words Used In Section 1962(c).

This Court has instructed that, "[i]n determining the scope of a statute, we look first to its language. If the statutory language is unambiguous, in the absence of 'a clearly expressed legislative intent to the contrary, that language must ordinarily be regarded as conclusive.' " *Russello v. United States*, 464 U.S. 16, 20 (1983), citing *United States v. Turkette*, 452 U.S. 576, 580 (1981), quoting from *Consumer Product Safety Comm'n v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980).

The unambiguous language of section 1962(c) makes it unlawful "for any person employed by or associated with any enterprise . . . to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity" 18 U.S.C. § 1962(c). In *Sedima*, this Court held that a violation of section 1962(c) requires "(1) conduct (2) of an enterprise (3) through a pattern (4) of racketeering activity." *Sedima, supra*, 473 U.S. at 496. Only the "conduct" element of section 1962(c) is directly at issue in this case. See *Arthur Young, supra*, 937 F.2d at 1324.

The "conduct" and "participate . . . in the conduct of" language of section 1962(c) "is not specifically defined in the

RICO statute.” *Russello, supra*, 464 U.S. at 21. “This silence compels [this Court] to ‘start with the assumption that the legislative purpose is expressed by the ordinary meaning of the words used.’” *Id.*, quoting from *Richards v. United States*, 369 U.S. 1, 9 (1962). To determine the ordinary meaning of undefined statutory terms, this Court frequently considers their dictionary definitions. *See, e.g., H.J. Inc. v. Northwestern Bell Tel.*, 492 U.S. 229, 238 (1989); *Russello, supra*, 464 U.S. at 21.

Section 1962(c) uses the term “conduct” as a verb *and* as a noun. When section 1962(c) uses “conduct” as a verb, as in the phrase “to conduct . . . such enterprise’s affairs,” “conduct” means “manage” according to Black’s Law Dictionary 367 (5th ed. 1979). Webster’s Ninth New Collegiate Dictionary 274 (1987)—which identifies “manage” as a synonym of the verb “conduct”—defines “conduct” in language virtually identical to the language used in the decision below: “to direct or take part in the operation or management of . . . a business [emphasis added.]” Random House Dictionary of the English Language 426 (2d ed. 1987) also defines the verb “conduct” to mean “manage” and offers these illustrations: “to conduct a meeting; to conduct a test.” *See also* Webster’s Third New International Dictionary 474 (1976) (verb “conduct” defined as “manage;” “manage” identified as a synonym of the verb).³

When section 1962(c) employs the term “conduct” as a noun, in the phrase “participate . . . in the conduct of such enterprise’s affairs,” the noun “conduct” means “management,” as in “the conduct [or management] of a business.” Random House Dictionary of the English Language 426 (2d ed. 1987). Webster’s Ninth New Collegiate Dictionary 274 (1987) similarly defines “conduct” to mean: “the act, manner, or process of carrying on: MANAGEMENT.”⁴ As

3 In the *amicus* brief submitted by Trial Lawyers for Public Justice (“TLPJ”) in support of petitioners, TLPJ admits that “‘conduct’ as a verb (‘to conduct’) may mean management, direction, etc.” Brief for TLPJ at 24.

4 Petitioners quote part of this definition in their brief; however, they omit the word “MANAGEMENT.” Brief for Petitioners at 23 n.12. The

(footnote continued)

defined there, “MANAGEMENT” is offered as synonymous with the noun “conduct,” and thus “may stand alone as the only definitional matter” for the noun. *Id.* at 21. Finally, Webster’s Third New International Dictionary 473 (1976) defines the noun “conduct” to mean: “the act, manner, or process of carrying out (as a task) or carrying forward (as a business . . .); MANAGEMENT[.]” *Accord Yellow Bus Lines, Inc. v. Drivers, Chauffeurs & Helpers Local Union* 639, 913 F.2d 948, 954 (D.C. Cir. 1990) (en banc), *cert. denied*, 111 S. Ct. 2839 (1991) (“‘Conduct’ is synonymous with ‘management’ or ‘direction’”).⁵

In short, the “ordinary meaning,” *Russello, supra*, 464 U.S. at 21, of the verb “conduct” demonstrates that section 1962(c)’s use of that term is synonymous with the verb “manage” (as in “to [manage] . . . [an] enterprise’s affairs through a pattern of racketeering activity”). Dictionary definitions of the noun “conduct” similarly demonstrate that section 1962(c)’s use of that term is synonymous with the noun “management” (as in “participate . . . in the [management] of such enterprise’s affairs through a pattern of racketeering activity”).

(footnote continued)

prepositional phrase “in the conduct of” is the nounal form of the verb “to conduct,” and has—as the dictionary definitions in text make clear—a denotation distinct from the noun “conduct” used in a different construction to mean “behavior” generally. *Compare* definitions 2 and 3 in Webster’s, *op. cit.* By truncating their references to the definition, petitioners lose this nuance, which is critical to the usage employed by Congress.

5 In a flawed attempt to support petitioners, TLPJ (note 3, *supra*) argues that, if the noun “conduct” is read to mean “‘management,’ it becomes superfluous” because “[t]he sentence would read ‘to manage . . . in the management of.’” Brief for TLPJ at 24-25. This argument contradicts common sense and it is based on a tortured construction of section 1962(c). For example, it is not superfluous “to manage *or* participate, directly or indirectly, in the management of such enterprise’s affairs[.]” *See* 18 U.S.C. § 1962(c) (emphasis added).

B. The "Operation Or Management" Standard Is Supported By An Analysis Of Section 1962(c)'s Legislative History.

As this Court has observed, "there is no errorless test for identifying or recognizing 'plain' or 'unambiguous' language." *Turkette*, 452 U.S. at 580. Thus, "[f]or any more specific guidance as to the meaning of" statutory terms not defined in the statute, *H.J.*, *supra*, 492 U.S. at 238-39, this Court "must look past the text to RICO's legislative history," *id.* at 239, just as it "ha[s] done in prior cases construing the Act." *H.J.*, *supra*, citing, *inter alia*, *Sedima*, *supra*, 473 U.S. at 486-90; *Russello*, *supra*, 464 U.S. at 26-29; *Turkette*, *supra*, 452 U.S. at 589-93. Section 1962(c)'s legislative history demonstrates that RICO's primary sponsors intended section 1962(c)'s term "conduct" to require some involvement by the RICO defendant in the "operation or management" of the enterprise's affairs.

On January 15, 1969, Senator McClellan, chairman of the Senate Judiciary Committee, introduced S.30, known as the Organized Crime Control Act of 1969; the bill addressed various areas of criminal law, including grand juries, immunity and sentencing, but it "contained no provision like that now known as RICO." *Sedima*, *supra*, 473 U.S. at 515 (Marshall, J., dissenting); see 115 Cong. Rec. 769 (1969); H. Rep. No. 91-1549, 91st Cong., 2d Sess. (1970) reprinted in 1970 U.S. Cong. Code & Ad. News 4007, 4012 (hereinafter the "House Report" or "H. Rep. No. 91-1549"). Shortly thereafter, Senator Hruska introduced S.1623, the Criminal Activities Profits Act. See *Sedima*, *supra*; 115 Cong. Rec. 6995-96 (1969); Lynch, *RICO: The Crime of Being a Criminal, Parts I & II*, 87 COLUM. L. REV. 661, 676 (1987) (hereinafter "Lynch, *RICO: The Crime*"). Senator Hruska explained that S.1623 was intended to attack "the economic power of organized crime and its exercise of unfair competition with honest businessmen" and that it was "aimed specifically at racketeer infiltration of legitimate business." 115 Cong. Rec. 6993 (1969).

In his introductory remarks regarding S.1623, Senator Hruska referred specifically to the ownership and operation

of legitimate businesses by racketeers and organized crime as activities that the bill was intended to eliminate:

It is tragic for the public to permit racketeers to *own and operate* ostensibly legitimate businesses.

115 Cong. Rec. at 6993 (emphasis added). In order to attack the ownership and operation of legitimate enterprises by racketeers and organized crime, section 2(c) of S.1623 made it a felony for any person to use "intentionally unreported income derived by such person from a proprietary interest in any business enterprise" to "*establish or operate* any such other business enterprise" 115 Cong. Rec. at 6995-96 (emphasis added); see Lynch, *RICO: The Crime*, *supra*, at 676.

The Senate "did not act directly on either S.30 or S.1623." *Sedima*, *supra*, 473 U.S. at 516 (Marshall, J., dissenting). "Instead, Senators McClellan and Hruska jointly introduced S.1861, the Corrupt Organizations Act of 1969, 91st Cong., 1st Sess.; 115 Cong. Rec. 9568-9571, which combined features of the two other bills and added to them." *Id.*; see also Lynch, *RICO: The Crime*, *supra*, at 676-77. Significantly, Senator McClellan described S.1861 as an amendment to Title 18 of the United States Code designed to "prohibit the infiltration *or management of legitimate organizations* by racketeering activity or the proceeds of racketeering activity." 115 Cong. Rec. 9568 (emphasis added).

As introduced, section 1962 of S.1861, the "core of the statute,"⁶ had three subsections that in substantial part later were enacted as sections 1962(a), (b) and (c). See 115 Cong. Rec. at 9569; compare 18 U.S.C. §§ 1962(a)-(c).⁷ Senator McClellan's introductory remarks for S.1861 noted that:

⁶ Lynch, *RICO: The Crime*, *supra*, at 680.

⁷ Section 1962(c) of S.1861 provided:

It shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in

(footnote continued)

Section 1962 sets forth the forbidden activities, which are to acquire, control or *operate* organizations by the use of a pattern of racketeering activity as defined in section 1961[.]

115 Cong. Rec. at 9567 (emphasis added). Senator McClellan also explained that, because S.1861 was primarily remedial, the focus of the bill was on eliminating the influence of persons who acquired or operated legitimate organizations through a pattern of racketeering activity:

If an organization is acquired *or run* by the proscribed racketeering method, then the persons involved are [to be] removed from the organization.

Id. (emphasis added).

In light of Senator McClellan's unambiguous remarks regarding the use of section 1962 to eliminate racketeers and organized crime from the "management" and "operat[ion]" of legitimate organizations, and the use in section 1962(c) of S.1861 of "conduct" and "participate" language identical to that used in section 1962(c) as enacted, the bill's sponsor apparently viewed "management," "operate" and "conduct" as terms of ordinary meaning that could be used interchangeably in section 1962(c).⁸

At the request of Senator McClellan, the provisions of S.1861 were incorporated by amendment into S.30. *Sedima*,

(footnote continued)

the conduct of such enterprise's affairs through a pattern of racketeering activity.

115 Cong. Rec. 9569 (1969). The only change between section 1962(c) as introduced as part of S.1861 and as enacted as part of Title 18 of the United States Code is that the phrase "or collection of an unlawful debt" was inserted after the terms "pattern of racketeering activity." As enacted, section 1962(d) prohibited conspiracies to violate the other three substantive provisions of section 1962.

⁸ Senator McClellan's remarks are entitled to special deference because "[i]t is the sponsors that we look to when the meaning of the statutory words is in doubt." *Schwegmann Bros. v. Calvert Distillers Corp.*, 341 U.S. 384, 394-95 (1951) (Douglas, J.).

supra, 473 U.S. at 516 (Marshall, J., dissenting); 115 Cong. Rec. 9566-71 (1969). On December 16, 1969, the Senate Judiciary Committee reported favorably on S.30, as amended to include S.1861. See S. Rep. No. 91-617, 91st Cong., 1st Sess. (1969) (hereinafter the "Senate Report" or "S. Rep. No. 91-617").

The Senate Report explains that Title IX of S.30 "creates a new chapter in title 18, entitled 'Racketeer Influenced and Corrupt Organizations,' which contains a threefold standard" in section 1962 designed to eliminate the infiltration of legitimate organizations. S. Rep. No. 91-617, *supra*, at 34; see Lynch, *RICO: The Crime*, *supra*, at 678 n.83.⁹ According to the Senate Report, the third prong of this standard (which correlates to section 1962(c) as enacted):

proscrib[es] the *operation* of any enterprise engaged in interstate commerce through a "pattern" of "racketeering activity[.]"

Id. (emphasis added).

According to the Senate Report, Title IX authorized district courts to use "civil process" to "prevent and restrain . . . violations of the above standard by, among other things, the issuance of (1) orders of divestment, (2) prohibitions of business activity, and (3) orders of dissolution or reorganization." S. Rep. No. 91-617, *supra*, at 34. The Senate Report explained that these "new remedies" were

⁹ In response to a request by the Senate Judiciary Committee "for the Department of Justice's views on S.1861[.]" the Department of Justice responded in a letter dated August 11, 1969, which stated in pertinent part:

The prohibitions contained in section 1962 of the bill appear to be broad enough to cover most of the methods by which *ownership, control, and operation of business* are achieved.

S. Rep. No. 91-617, *supra*, at 123 (emphasis added). When read in its entirety, this letter reflects an understanding on the part of the Department of Justice that Congress sought to address the operation of businesses by racketeers and organized crime through section 1962(c) of S.1861. The fact that the Senate Judiciary Committee included the letter in its Report without reservation or qualification suggests strongly that Congress agreed with the letter's content. See, e.g., *Palmer v. Hoffman*, 318 U.S. 109, 112 n.3 (1943).

designed to eliminate racketeers and organized crime from the "acquisition" and "operation" of legitimate businesses:

Title IX recognizes that present efforts to dislodge the forces of organized crime from legitimate fields of endeavor have proven unsuccessful. To remedy this failure, the proposed statute adopts the most direct route open to accomplish the desired objective. Where an organization is acquired *or run* by defined racketeering methods, then the persons involved can be legally separated from the organization, either by the criminal law approach of fine, imprisonment and forfeiture, or through a civil law approach of equitable relief broad enough to do all that is necessary to free the channels of commerce from all illicit activity.

Id., at 79 (emphasis added). The Senate Report concluded that removing "criminal elements from the organizations of our society by divestiture is justified" because Title IX attacks "the use of force, threats of force, enforcement of illegal debts, and corruption in the acquisition *or operation of business.*" *Id.*, at 81 (emphasis added).¹⁰

On January 23, 1970, the Senate passed S.30, after which the bill was considered by the House. *Sedima, supra*, 473 U.S. at 518 (Marshall, J., dissenting); H. Rep. No. 91-1549, *supra*, at 4012. In the House, Representative Celler explained that Title IX was "designed to inhibit the infiltration of legitimate business by organized crime" and that, under section 1962(c), "[t]he conduct of the affairs of a business *by a person acting in a managerial capacity*, through racketeering activity[,] is also proscribed." 116 Cong. Rec. 35196 (1970) (emphasis added). Representative Railsback similarly explained that section 1962 "makes it a crime to use organized crime profits or methods to establish, acquire, *or oper-*

¹⁰ The Senate Report also notes that, by "effectively remov[ing] the criminal figure from the particular corrupt organization[,] the "prohibition is not a penalty against any individual[,] but "instead a protection of the public against parties engaging in certain types of businesses after they have shown that they *are likely to run the organization* in a manner detrimental to the public interest." S. Rep. No. 91-617, *supra*, at 82 (emphasis added).

ate any legitimate business." 116 Cong. Rec. 35304 (1970) (emphasis added).

In September 1970, the House Judiciary Committee reported favorably on S.30, with amendments, *see* H. Rep. No. 91-1549, *supra*, at 4012, after which the Senate passed the bill without a conference as the Organized Crime Control Act of 1970. *Sedima, supra*, 473 U.S. at 519 (Marshall, J., dissenting); Pub. L. No. 91-452, 84 Stat. 922, 941 (1970).

The foregoing review of the legislative history of section 1962(c)—particularly the repeated use of the word "operation" to describe the substantive scope and purpose of section 1962(c)—demonstrates that the statutory term "conduct" requires some involvement by defendants in the operation or management of enterprises. This requirement appears to reflect both a legislative determination to focus the statute's prohibitions on the conduct Congress had found offensive to the public interest and a decision that exposure to the severe sanctions available under RICO should be kept within expressly defined bounds by triggering them only upon a showing that defendants have a significant degree of involvement in the affairs of a RICO enterprise.

C. The "Operation Or Management" Standard Has Been Adopted By Most Courts That Have Considered The Separate "Conduct" Element Of Section 1962(c).

Section 1962(c)'s requirement that a defendant "conduct or participate . . . in the conduct of [an] enterprise's affairs" is an element separate from the requirement that an enterprise's affairs be conducted "through a pattern" of racketeering activity. *See Sedima, supra*, 473 U.S. at 496.¹¹ Most Courts of Appeals which have construed the "conduct" element, as distinct from the "through" element, have concluded that the

¹¹ *Accord Occupational-Urgent Care Health Systems, Inc. v. Sutro & Co.*, 711 F. Supp. 1016, 1026-27 (E.D. Cal. 1989) (complaint's allegations held inadequate to satisfy either "conduct" element or "through" element); *Lipin Enterprises v. Lee*, 625 F. Supp. 1098, 1100 (N.D. Ill. 1985) (same), *aff'd*, 803 F.2d 322 (7th Cir. 1986). The United States in its *amicus* brief to this Court concedes that section 1962(c)'s "conduct" element is separate from the statute's "through" element. *See* Brief for United States at 8.

"conduct" element requires proof of participation in the "operation or management" of the enterprise. See *United States v. Mandel*, 591 F.2d 1347, 1375 (4th Cir. 1979), *cert. denied*, 445 U.S. 961 (1980); *United States v. Zemek*, 634 F.2d 1159, 1172 (9th Cir. 1980), *cert. denied*, 450 U.S. 916 (1981); *Bennett v. Berg*, 710 F.2d 1361, 1364 (8th Cir.) (en banc), *cert. denied*, 464 U.S. 1008 (1983); *Yellow Bus Lines, Inc. v. Drivers, Chauffeurs & Helpers Local Union 639*, 913 F.2d 948, 952-54 (D.C. Cir. 1990) (en banc), *cert. denied*, 111 S. Ct. 2839 (1991); but see *Bank of America v. Touche Ross & Co.*, 782 F.2d 966, 970 (11th Cir. 1986) (expressly rejecting the *Bennett* "operation or management" standard after analyzing section 1962(c)'s "conduct" element separately); cf. *Akin v. Q-L Investments, Inc.*, 959 F.2d 521, 533-34 n.8 (5th Cir. 1992).¹²

In *Mandel*, a panel of the United States Court of Appeals for the Fourth Circuit decided that a transfer of a partnership interest in a RICO enterprise from one defendant to another was insufficient to satisfy the "conduct or participate" element of section 1962(c). In doing so, the court extensively reviewed the legislative history of section 1962(c), "particularly the repeated use of the word 'operation' in describing the purpose of § 1962(c)," and concluded that the "'conduct or participate' language in § 1962(c) require[s] some involvement in the operation or management of the business." 591 F.2d at 1375.¹³ The Fourth Circuit's decision in *Mandel* has been followed in three other circuits. In *Zemek*, the United States Court of Appeals for the Ninth Circuit adopted *Mandel's* "operation or management" standard in reviewing the sufficiency of the evidence in a RICO

¹² Petitioners therefore err in their contention that the Eighth Circuit's "operation or management" standard has been rejected by "other circuits (six of which have conflicting tests)." Brief for Petitioners at 31.

¹³ The *Mandel* court also concluded that the "through" element had not been satisfied because "the simple transfer of an ownership interest" in a "perfectly legitimate business" does not "constitute the conduct of the business through a pattern of racketeering activity even if the transfer is part of an alleged payoff in a mail fraud scheme." *Id.* at 1376.

criminal case, and concluded there was "ample evidence of Zemek's participation and involvement in the operation" of an illegal association-in-fact enterprise (defined as the business of operating taverns in Pierce County, Washington) in the proof that Zemek solicited someone to burn a rival tavern and made admissions regarding his involvement in other acts of arson. 634 F.2d at 1171-72.¹⁴ In a decision which the court below expressly followed, the United States Court of Appeals for the Eighth Circuit, sitting *en banc*, held in *Bennett v. Berg* (following *Mandel*), that "[a] defendant's participation must be in the conduct of the affairs of a RICO enterprise, which ordinarily will require some participation in the operation or management of the enterprise itself." 710 F.2d at 1364.¹⁵ In *Yellow Bus*, the United States Court of Appeals for the District of Columbia Circuit, sitting *en banc*, adopted in substantially identical form the standard announced in *Bennett*, and held that section 1962(c) is satisfied "when a defendant, through a pattern of racketeering activity, exercises significant control over or within an enterprise, participating not merely in the enterprise's affairs, but in the

¹⁴ Petitioners and certain *amici* that support them err in their suggestion that the Ninth Circuit, in *United States v. Yarbrough*, 852 F.2d 1522, 1544 (9th Cir.), *cert. denied*, 488 U.S. 866 (1988), adopted a different construction of section 1962(c)'s "conduct" element. See Brief for Petitioners at 40 n.16; Brief for United States at 9 n.7; Brief for NASCAT at 11-14. In *Yarbrough*, the Ninth Circuit construed only the "through" element of section 1962(c). The "conduct or participate" element was not even addressed because the defendant admitted his membership in the radical right-wing, white-supremacist group known as the "Order"—an illegal association-in-fact enterprise—and also admitted that he had "engaged in a 'pattern of racketeering activity[.]'" 852 F.2d at 1526, 1544.

¹⁵ In its decision below, the panel, noting that it was "bound" to follow *Bennett*, applied the *Bennett* standard and concluded that the acts of Arthur Young "in no way rise to the level of participation in the management or operation of the Co-op." See *Arthur Young*, *supra*, 937 F.2d at 1324. Petitioner's assertion that the adoption of the "operation or management" standard in *Bennett* was dictum which the court below was free to ignore is wrong. See Brief for Petitioners at 31.

conduct of the enterprise's affairs." 913 F.2d at 954 (emphasis in original).¹⁶

The Institute respectfully submits that the Eleventh Circuit erred in its conclusion in *Bank of America* that "[i]t is not necessary that a RICO defendant participate in the management or operation of the enterprise." 782 F.2d at 970. The Eleventh Circuit rejected the "operation or management" standard based on a misunderstanding that "[t]he word 'conduct' in § 1962(c) simply means the performance of activities necessary or helpful to the operation of the enterprise." *Bank of America, supra*, 782 F.2d at 970 (citing *United States v. Martino*, 648 F.2d 367, 382 (5th Cir. 1981), *aff'd on other grounds sub nom., Russello v. United States*, 464 U.S. 16 (1983)). Such a construction effectively renders the "conduct" element meaningless, since it is hard to conceive of a case in which a "pattern of racketeering activity" could be shown in which "activities necessary or helpful to the operation of the enterprise" would not necessarily be shown by the same proof. The fallacy of the Eleventh Circuit's interpretation, which leaves the "conduct" language of RICO as surplusage, is demonstrated by the fact that it relied on a case interpreting "conduct" in a very different context where the

¹⁶ Petitioners contend that the decision below, by relying upon *Yellow Bus*, modified the *Bennett* "operation or management" standard so as to require defendants to have "'exercised significant control over management or operations' or some variant of that." See Brief for Petitioners at 32-34. A fair reading of the opinion below shows that *Yellow Bus* merely was cited as an example of a decision that discussed the ostensible "inconsistencies between the circuits regarding the necessary level of participation for RICO liability." See *Arthur Young, supra*, 937 F.2d at 1324. After citing *Yellow Bus* for that limited point, the court adhered to the *Bennett* standard as written. See *Arthur Young, supra*, 937 F.2d at 1324. By juxtaposing *Bennett* and *Yellow Bus*, petitioners seek to construct a straw man "control" issue that would divert this Court's attention from the issue on which it granted certiorari. See Petition for Writ of Certiorari, at i. Petitioners also sought to interject the "control" issue in the question presented in their brief on the merits, even though no such issue was fairly included in the question on which this Court granted certiorari. See Supreme Court Rule 14.1(a). This change in the substance of the question presented (see Brief for Petitioners at i) is impermissible under Supreme Court Rule 34.1(a).

meaning accorded it by the court did endow it with content. In *Martino*, the Fifth Circuit's construction of the word "conducts" was drawn from *United States v. Tucker*, 638 F.2d 1292 (5th Cir.), *cert. denied*, 454 U.S. 833 (1981), which involved 18 U.S.C. § 1955—an entirely different statute from RICO. That statute penalizes one who "conducts" an illegal gambling business. See *Martino, supra*, 648 F.2d at 382.

Finally, decisions such as *United States v. Scotto*, 641 F.2d 47, 53-54 (2d Cir. 1980), *cert. denied*, 452 U.S. 961 (1981), and *United States v. Cauble*, 706 F.2d 1322, 1332 (5th Cir. 1983), *cert. denied*, 465 U.S. 1005 (1984), on which petitioners rely, cannot properly be read as addressing the statutory issue before this Court, much less as supporting a construction of the term "conduct" different from that adopted by the court below.¹⁷ The "conduct" element of section 1962(c) was not at issue in *Scotto*; the defendant there was a high-ranking official in Local 1814 of the International Long-

¹⁷ See also *Akin v. Q-L Investments, supra*, 959 F.2d at 533-34 and n.8 (incorrectly follows *Cauble* as controlling test for determining whether "a defendant participates in the conduct of an enterprise's affairs" for purposes of section 1962(c)); *Yellow Bus Lines, Inc. v. Drivers, Chauffeurs & Helpers Local Union 639*, 913 F.2d 948, 952-54 (D.C. Cir. 1990) (en banc) (refers incorrectly to decisions interpreting § 1962(c)'s "through" element as decisions interpreting its "conduct" element), *cert. denied*, 111 S. Ct. 2839 (1991); *Heritage Ins. Co. v. First Nat'l Bank of Cicero*, No. 84 C 8747, 1985 WL 1872 (N.D. Ill. June 25, 1985) (same); D. Abrams, *THE LAW OF CIVIL RICO*, § 4.7.3, at 233-42 (1991) (hereinafter "*LAW OF CIVIL RICO*") (same); 9A Dep't of Justice Manual, ch. 110A, *Racketeer Influenced and Corrupt Organizations (RICO): A Manual for Federal Prosecutors*, at 83-88 (1991) (hereinafter "*Manual for Federal Prosecutors*") (same). The Department of Justice misunderstood *Scotto* and *Cauble* as decisions construing the "conduct or participate" element. See *Manual for Federal Prosecutors, supra*, at 84 n.172. *Scotto* construed only the "through" element. *Scotto, supra*, 641 F.2d at 53-54. In *Cauble*, the Fifth Circuit merely acknowledged that the "defendant-racketeering connection" and "enterprise-racketeering nexus" were separate concepts; the remainder of the court's discussion modified the *Scotto* "nexus" standard. See *Cauble, supra*, 706 F.2d at 1331-33, 1341. Therefore, petitioners and certain of the *amici* that support them are in error in relying on *Scotto*, *Cauble* and other "nexus" cases as decisions interpreting section 1962(c)'s "conduct or participate" element more favorably than *Bennett* or the decision below. See Brief for Petitioners at 40 n.16; Brief for United States at 9 n.7; Brief for NASCAT at 11-14.

shoremen's Association, the alleged RICO "enterprise." *Scotto, supra*, 641 F.2d at 50, 53-54. Nor was the "conduct" element at issue in *Cauble*; the defendant there was a general partner of Cauble Enterprises (the RICO enterprise), which gave him the "ability to dispatch the Cauble Enterprises airplane and to use Cauble Enterprises' assets to pay for commercial flights." *Cauble, supra*, 706 F.2d at 1341.¹⁸ Thus, *Scotto* and *Cauble*, and decisions from other circuits construing a different element of section 1962(c),¹⁹ are of doubtful relevance to the issue before this Court.²⁰

18 In construing section 1962(c)'s "through" (or "nexus") element, several courts have adopted standards which contain elements similar to the Eighth Circuit's formulation of the "conduct" element in *Bennett*. The Ninth Circuit in *Sun Savings & Loan Ass'n v. Dierdorff*, 825 F.2d 187 (9th Cir. 1987), defined the "nexus" element as follows:

[A] nexus exists "when (1) one is enabled to commit the predicate offenses solely by virtue of his position in the enterprise or involvement in or control over the affairs of the enterprise, or (2) the predicate offenses are related to the activities of that enterprise."

Sun Savings, supra, 825 F.2d at 195, quoting *United States v. Scotto*, 641 F.2d 47, 54 (2d Cir. 1980), cert. denied, 452 U.S. 961 (1981). See, e.g., *A.G. Edwards & Sons, Inc. v. Smith*, 736 F. Supp. 1030, 1037-38 (D. Ariz. 1989) (following *Sun Savings*); *Richmark Corp. v. Timber Falling Consultants, Inc.*, 730 F. Supp. 1525, 1534 (D. Or. 1990) (same).

19 See, e.g., *United States v. Pieper*, 854 F.2d 1020, 1026 (7th Cir. 1988) (analyzing requisite nexus between racketeering activity and enterprise's affairs); *United States v. Horak*, 833 F.2d 1235, 1239 (7th Cir. 1987) (same).

20 In the United States' amicus brief in support of petitioners, the Solicitor General ignores the structure of RICO and attempts to collapse the separate "conduct" and "through" elements by urging that decisions such as *Scotto* and *Cauble* "integrate into a single inquiry the issue whether the defendant 'conducted or participated' in the conduct of the enterprise's affairs, and whether he did so 'through' a pattern of racketeering activity." Brief for United States at 9 n.7. While the proof to satisfy each element may overlap, see, e.g., *Turkette, supra*, 452 U.S. at 583; *United States v. Mazzei*, 700 F.2d 85, 89 (2d Cir.), cert. denied, 461 U.S. 945 (1983), and the standards governing the requisite degree of proof to satisfy each element may contain similarities, see, e.g., *Pieper, supra*, 854 F.2d at 1026-27; *Sun Savings, supra*, 825 F.2d at 194-95; *Cauble, supra*, 706 F.2d at 1331-33, the

(footnote continued)

For all of the reasons discussed above, the Institute respectfully submits that the "operation or management" standard is the correct standard for this Court to endorse. It will ensure that liability under RICO will be kept within legislatively defined bounds by requiring that RICO defendants have a significant degree of involvement in the affairs of a RICO enterprise.

POINT II

THE DECISION BELOW SHOULD BE AFFIRMED BECAUSE IT PROMOTES CERTAINTY REGARDING THE BOUNDARIES OF CIVIL LIABILITY IN COMMERCIAL RICO CASES.

Notwithstanding "the congressional admonition that RICO be 'liberally construed to effectuate its remedial purposes,'" this Court recently acknowledged its "fear that RICO's remedial purposes would more probably be hobbled than helped by [a RICO plaintiff's] version of liberal construction" that would allow suits to proceed in derogation of RICO's plain language, legislative history and statutory scheme. *Holmes v. Securities Investor Protection Corp.*, 112 S. Ct. 1311, 1321 (1992). This Court's recent decisions interpreting RICO by assigning primary importance to the words of the statute, its structure, and its legislative history, reflect the basic policy considerations that civil liability should be defined by the statutory language, read in context and confined within legislatively mandated bounds. See, e.g., *Turkette, supra*;

(footnote continued)

terms "conduct" and "through a pattern" remain separate elements which serve distinct statutory purposes, *Sedima, supra*, at 473 U.S. at 496. *Scotto* and *Cauble* do not hold otherwise, nor would the result in these cases have been different had the *Bennett* "operation or management" standard been applied. Indeed, in each of the cases cited by the Solicitor General as involving "characteristic applications" of RICO (see Brief for United States at 19), it can be said that the defendant had "some participation" in at least the "operation" if not also the "management" of the enterprise. See *Bennett, supra*, 710 F.2d at 1364.

Sedima, supra; *H.J., supra*. By urging this Court to reverse the decision below, and thus effectively to write section 1962(c)'s "conduct" requirement out of the statute, petitioners disregard these grave policy concerns raised by an expansive view of RICO liability.

A. Vexatious RICO Litigation Should Be Discouraged.

Although Congress enacted RICO to create a new, effective weapon in the war against the infiltration of legitimate businesses by racketeers and organized crime, it has become increasingly common for plaintiffs' counsel to view the primary purpose of a civil RICO lawsuit as a means to extract large settlements from legitimate businesses. See 137 Cong. Rec. E1219-02 (1991) (remarks of Rep. Hughes); Wright, *Why Are Professionals Worried About RICO?*, 65 NOTRE DAME L. REV. 983, 993 (1990). When legitimate businesses are confronted with civil RICO lawsuits seeking treble damages and attorney's fee awards some defendants are willing to settle even claims that have no merit; in this regard, "RICO has been used for extortive purposes, giving rise to the very evils it was designed to combat." *Sedima*, 473 U.S. at 506 (Marshall, J., dissenting), citing Report of the Ad Hoc Civil RICO Task Force of the ABA Section of Corporation, Banking and Business Law 69 (1985); see also Harrison, *Look Who's Using RICO*, 75 A.B.A.J. 56 (1990) (the "threat of an unsympathetic jury has pressured many defendants into settlement figures that were simply unheard of previously"). Justice O'Connor recently observed that, "[i]n addition to the threat of treble damages, a defendant faces the stigma of being labeled a 'racketeer[.]' " as well as "the very real specter of vexatious litigation based on speculative damages" when RICO claims are based on predicate acts of securities fraud. *Holmes, supra*, 112 S. Ct. at 1327 (O'Connor, J., concurring).

A statute which induces private parties to settle actions without regard for the merits of the claim undermines the rule of law. As noted above, some plaintiffs file RICO cases solely to extract a settlement and RICO claims are often set-

tled without regard to the merits. See Crovitz, *RICO: The Legalized Extortion and Shakedown Racket*, in *THE RICO RACKET* 15, 26-27 (1989); see also Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV. 497, 568-70 (1991). A legal system that places a disproportionate monetary burden on defendants who are comparatively free of blame, but happen to have deep pockets, "dilutes the moral force of the law and breeds cynicism on the part of those deep pockets who are targets." Wright, *supra*, at 994.

B. Harm To The Accounting Profession.

Accountants have been particularly hard hit by the civil RICO litigation explosion because the services they provide cause them to be named in RICO lawsuits on a regular basis. See Gossman, *The Fallacy of Expanding Accountants' Liability*, 1 COLUM. BUS. L. REV. 213, 215 (1988); Wright, *supra*, at 992; Temes, *Firms Chasing Clients, Top Pros of Laven-thol*, Crain's New York Business, Nov. 26, 1990, at 1 (a number of accounting firms face potential liability as large or larger than bankrupt Laven-thol Horwath in large part due to RICO's treble damages provision). In part, this is due to the complexity of the certified public accountant's function and a pervasive misunderstanding of Generally Accepted Accounting Principles and Generally Accepted Auditing Standards that some commentators have called an "expectation gap": "a difference between what the public and financial statement users believe accountants and auditors are responsible for and what the accountants and auditors themselves believe they're responsible for." Guy & Sullivan, *The Expectation Gap Auditing Standards*, J. ACCT. 36 (Apr. 1988). A related but separate reason why auditors are frequently named as defendants is that, "[f]rom [the public misperception of the auditor's duties] flows an erroneous legal supposition that [the auditor's] responsibility should be co-extensive with that of the client." Minow, *Accountants' Liability and the Litigation Explosion*, J. ACCT. 70, 77-78 (Sept. 1984).

Another reason why accountants have been particularly vulnerable to civil RICO litigation is that, in the current economic environment, it has become common for plaintiffs to bring RICO claims against accountants in their search for "deep pockets" when the accountants' clients enter bankruptcy or encounter financial difficulties: "Some investors and creditors automatically sue accountants and their firms when businesses fail without regard to what caused the failure There is an obvious lure in suing the accounting firms, for they are frequently the only solvent party left standing in the wake of corporate bankruptcy." Minow, *supra*, at 76. This problem also exists in the non-bankruptcy context, where investors in businesses bring lawsuits to recoup economic losses caused by an upheaval in the market or the improper actions of the accountant's client. See Wright, *supra*, at 991-92; Mednick, *Accountants' Liability: Coping With the Stampede to the Courtroom*, J. ACCT. 118 (Sept. 1987); Galen, *Litigation Blitz Hits Accountants*, Nat'l L.J., June 16, 1986, at 1, 26 col. 1. As one class action attorney explained, "[s]omeone has to pay when a person . . . invests in a company that goes sour." Berton, *Investors Call CPAs to Account*, Wall St. J., Jan. 28, 1985, at 30, col. 4.

One commentator on insurance insolvencies has referred to accountants as "preferred defendants" and counseled in favor of filing RICO claims against auditors as a means of inducing "an earlier and more favorable settlement[.]" Howard, *Making Accountants Account For Themselves When An Insurance Company Has No Tomorrows*, FICC QUARTERLY 342, 343 (Summer 1990). This type of advice demonstrates why RICO should not be interpreted more broadly than it already is, especially given the ease with which a RICO lawsuit against an accountant can be built "on a scaffolding of the merest guesswork and supposition, junk science and prejudicial tidbits." W. Olsen, *THE LITIGATION EXPLOSION* 289 (1991). It is therefore not surprising that, in the single year subsequent to *Sedima* alone, at least 22 RICO suits had been filed against small CPA firms who have AICPA insurance and at least 31 against larger firms. Galen, *supra*, at 27, col. 1.

The improper use of civil RICO threatens accountants with more than just economic harm. As professionals, accountants and accounting firms depend for their livelihood on fostering a reputation for careful, high-quality work. See *DiLeo v. Ernst & Young*, 901 F.2d 624, 629 (7th Cir.), *cert. denied*, 111 S. Ct. 347 (1990). In many instances, accounting firms feel pressured to settle RICO claims quickly because the mere filing of a RICO complaint can cause substantial harm to the reputation of an accounting firm, which is arguably its "most valuable economic asset." *O'Brien v. Price Waterhouse*, 740 F. Supp. 276, 280 (S.D.N.Y. 1990), *aff'd sub nom.*, *O'Brien v. National Property Analyst Partners*, 936 F.2d 674 (2d Cir. 1991). Excessive exposure to RICO liability even threatens to drive young and talented professionals away from the field of accounting, which in turn threatens the future of the profession. As an additional consequence, qualified individuals are declining to join accounting partnerships in ever-increasing numbers. See Cowan, *The New Letdown: Making Partner*, N.Y. Times, Apr. 1, 1992, at D1. If this Court adopts the expansive view of RICO offered by petitioners, it is certain that civil RICO liability will pose an even more serious threat to the future of the accounting profession than the grave threat it poses now.

C. Harm To Users Of Accountants' Services.

Potentially indeterminate liability under RICO could limit or, in certain instances, eliminate the availability of high-quality accounting services. Some accounting firms may refuse to provide their services to smaller clients. One attorney who represents accounting firms presented the problem pointedly: "Why should someone do an audit that pays them \$25,000 and subject themselves to \$25 million in liabilities? No one in their right mind is going to do that." *Applicability of RICO to Accountants For Banks, S&Ls to Be Heard by High Court*, The FDIC Watch, March 2, 1992, vol. 2, no. 8, at 3. Moreover, accountants may also refuse to audit enterprises they perceive as risky. See, e.g., McCarroll, *Who's Counting?*, Time, April 13, 1992, at 48, 50 ("[A]ccounting

firms are abandoning the riskiest clients, most notably financial-services companies'''); Berton, *Legal-Liability Awards Are Frightening Smaller CPA Firms Away From Audits*, Wall St. J., March 3, 1992, at B1, B5 (accounting firms are turning down audits of public companies due to concerns that the work will lead to litigation); see generally Minow, *supra*, at 80; Siliciano, *Negligent Accounting and the Limits of Instrumental Tort Reform*, 86 MICH. L. REV. 1929, 1962-63 (1988). It is not surprising that larger firms are wary of the potential damage to their reputation that even a meritless RICO action can bring and that smaller firms are concerned that they may not be able to bear the substantial costs of defending a RICO action.

RICO litigation against accountants may also result in clients' being unable to pay the increased costs of high-quality accounting services. As the Seventh Circuit recognized in *DiLeo*, *supra*, 901 F.2d at 629, an overbroad extension of accountants' liability necessarily increases the costs of accounting services and thereby decreases the availability of these services. Clients who are unable to afford the increased cost of high-quality accounting services may turn to accounting firms who are less responsible, but cheaper. See Kirby & Davies, *Accountant Liability: New Exposure For An Old Profession*, 36 S.D.L. REV. 576, 595 n.200 (1991).

D. Harm To The Capital Markets.

The unwarranted expansion of accountants' liability under RICO may chill the free flow of financial information from high-quality accountants to businesses and investors. See McDonald, *Accountants' Liability to Third Parties: Unmanageable Risks of Foreseeability*, DEF. COUNS. J. 194, 198 (Apr. 1990) (unlimited duty decreases incentive to conduct audits and decreases flow of economic information). This problem is a serious one because accountants play an integral role in the dissemination of financial information, and the dissemination of such information to the investing public is a primary goal of the federal securities laws. See Securities Act

of 1933, 15 U.S.C. § 77aa (Schedule A)(25)-(27); and Securities Exchange Act of 1934, 15 U.S.C. § 78l(b)(1)(J)-(K).

Furthermore, the capital markets, through which securities are traded and resources are allocated, function under the principle of "informational market efficiency." Jagannathan & Palfrey, *Effects of Insider Trading & Disclosures on Speculative Activity and Future Prices*, 27 ECON. INQUIRY 411, 427 (1989); Gilson & Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549, 593 (1984); see *Basic Inc. v. Levinson*, 485 U.S. 224, 245-47 (1988). In an efficient capital market, firms can make production and investment decisions, and investors can choose among securities that represent ownership of issuing firms, under the assumption that security prices at any time fully reflect all available information. Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. FIN. 383 (May 1970). This has been recognized for a considerable period of time. See Douglas & Bates, *The Federal Securities Act of 1933*, 43 YALE L.J. 171, 172 (1933). A rule of law that inexorably tends to shrink the information available to businesses and investors by imposing exorbitant risk on its collection, analysis and dissemination, also tends to diminish the efficiency of capital markets. Such a rule embodies a very risky policy judgment and should not be fashioned by a court in the absence of a compelling legislative command.

E. Competition May Be Diminished.

The SEC has argued that the potential liabilities associated with civil RICO "impede capital formation" by issuers and may "discourage innovation by financial service providers," and thus, "put[] the United States at a competitive disadvantage by discouraging foreign involvement in our markets." *Statement of Mary L. Schapiro, Comm'r, SEC, Concerning RICO Amendments of 1991: Hearing on H.R. 1717 Before the Subcomm. on Intellectual Property and Judicial Administration of the House Judiciary Comm.*, quoted in 6 Civil RICO Report, at 1-2 (Apr. 30, 1991). One commentator has observed that expansive civil RICO liability can harm Ameri-

ca's competitive standing for the additional reason that accountants will be discouraged from implementing innovations within the accounting practice and from servicing "the kinds of new, daring entrepreneurial ventures that the economy so desperately needs, including experimental high-technology companies." Minow, *supra*, at 80. Again, the Court should not so interpret RICO as to run these economic policy risks when the statutory language and history so clearly do not compel it to do so.

CONCLUSION

For all of the foregoing reasons, the judgment of the Court of Appeals for the Eighth Circuit, insofar as it affirmed the District Court's grant of summary judgment to respondent, should be affirmed.

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